



## GLOBAL INVESTMENT GROWS AMERICA'S ECONOMY

### Michigan Senate Finance Committee

OFII Testimony on Passing SB 1097 to Decouple from §163(j)  
September 5, 2018

Chair Brandenburg, Vice Chairs Robertson and Bieda, and members of the Finance Committee:

On behalf of the Organization for International Investment (OFII), I urge the state to pass SB 1097 to decouple from the new interest expense deductibility limitations under IRC §163(j). Decoupling from this provision would remove a hidden corporate tax increase, alleviate compliance concerns and ensure the state remains competitive for international investment.

OFII is a trade association representing the U.S. subsidiaries of international companies, including nearly 80 Michigan employers. OFII's membership list is enclosed. OFII advocates for non-discriminatory treatment of U.S. subsidiaries and promotes policies that will encourage them to grow in the United States.

International companies have been essential to Michigan's recent economic growth. They employ 238,100 Michiganders.<sup>1</sup> But most impressively, in the past five years, jobs provided by international firms in Michigan grew by 63.8 percent vs. the state's overall private-sector growth rate of 13.1 percent. Nationwide, international firms produce 23 percent of U.S. exports, fund 16 percent of U.S. innovation efforts, account for 20 percent of the U.S. manufacturing workforce and pay 24 percent higher compensation than the economy-wide average.

Enclosed is OFII's policy principles document, which outlines several reasons for why states should decouple from IRC §163(j) to ensure international competitiveness. This issue is even more important to Michigan for the following reasons:

- The ability to deduct interest as an ordinary and necessary business expense is a longstanding principle of U.S. tax policy that reduces the cost of capital, which helps encourage investment and expansion. Having more capital translates into building new plants and facilities in the United States or acquiring new assets to further grow in this market. However, if Michigan fails to decouple from IRC §163(j), the state would limit interest deductibility, which would raise the cost of capital and increase taxes on Michigan employers. Analysis shows that simple conformity without decoupling would increase the state's corporate tax base by 9 percent.<sup>2</sup> In any year, base broadening to this extent would be realized only after thoughtful debate in the state legislature to understand whether higher taxes achieve worthwhile policy goals.
- Congress limited interest deductibility to pay for a lower federal corporate income tax rate, accelerated depreciation and immediate expensing. This way, companies are

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<sup>1</sup> Data is from the U.S. Department of Commerce's Bureau of Economic Analysis. Released October 2017.

<sup>2</sup> "The Impact of Federal Tax Reform on State Corporate Income Taxes," prepared by EY for the Council on State Taxation, and its affiliate, the State Tax Research Institute. Released March 5, 2018. Of all base broadeners, the limitations on interest expense deductibility is the largest increase to the federal corporate income tax base besides the one-time tax on repatriated earnings.

incentivized to invest in new assets without over-relying on debt financing. However, Michigan already decouples from federal bonus depreciation rules under IRC §168(k).<sup>3</sup> Therefore, Michigan should decouple from IRC §163(j) because Congress intended for these provisions to act together. Without decoupling from IRC §163(j), companies would be denied accelerated depreciation on purchased assets and interest expense deductibility at the same time – two policies that disincentivize investment and growth.

- Michigan taxpayers file state returns on a unitary combined basis but are preparing to determine interest limitations for federal returns on a federal consolidated group basis.<sup>4</sup> This ambiguity may make state compliance to IRC §163(j) difficult for taxpayers as the state reporting group could differ from the federal reporting group.
- Michigan has excelled at attracting international investment. Nearly 1,000 global employers have operations in Michigan, and 6.5 percent of the state's workforce is employed by international investors. Conforming to IRC §163(j) would increase the cost of capital and raise taxes on Michigan employers. By decoupling, Michigan would keep its competitive edge.

Other states are seizing the opportunity to improve their business environments this year. Connecticut, Georgia, Indiana, Tennessee and Wisconsin decoupled from the interest expense limitations in IRC §163(j).<sup>5</sup> Michigan competes with many of these states for jobs and investment, and the state should take efforts to remain competitive. For these reasons, OFII urges the Finance Committee to pass SB 1097.

Thank you for considering this testimony. If you have questions, please contact Evan Hoffman, OFII's Director of State Government affairs at [ehoffman@ofii.org](mailto:ehoffman@ofii.org) or (202) 659-1903.

Sincerely,



Nancy McLernon  
President and CEO, Organization for International Investment

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<sup>3</sup>See MCL 206.607(1) for state law decoupling from IRC §168(k)

<sup>4</sup> The U.S. Treasury Department issued a notice explaining that they intend to issue rules regarding how interest limitation and its carryforward will be determined at least on a federal consolidated group basis. However, even with this guidance, Michigan taxpayers file on a unitary combined basis, which could differ from their federal consolidated group, creating complexities and uncertainties.

<sup>5</sup> Georgia decoupled from IRC §163(j) in H.B. 918, enacted March 2. Wisconsin decoupled from IRC §163(j) in A.B. 259, enacted April 3. Indiana decoupled from IRC §163(j) in H.B. 1316, enacted May 14. Connecticut decoupled from IRC §163(j) in S.B. 11, enacted May 31. Tennessee decoupled from IRC 163(j) starting in 2020 in SB 2119, enacted May 21.

# Decouple from IRC §163(j) to Be Competitive for International Investment

## International Investment Grows America's Economy

- **Supporting Millions of High-Quality Jobs:** International companies employ 6.8 million U.S. workers providing compensation that is 24 percent higher than the economy-wide average.
- **Growing America's Manufacturing Sector:** International firms are responsible for one-in-five of all U.S. manufacturing jobs. In fact, two-thirds of the manufacturing jobs created in the past few years can be attributed to FDI.
- **Fueling American Innovation:** American scientists and engineers employed by international companies are leading our nation's innovation advantage. International employers spend more than \$57 billion on research and development activities, or 16 percent of America's private-sector R&D.
- **Exporting American-Made Goods:** U.S. workers of international companies produce 23 percent of U.S. exports, shipping nearly a billion dollars in goods a day to customers around the world.
- **Importing World-Class Workforce Training Programs:** These companies also "import" world-class workforce training programs and help spur U.S. productivity.
- **FDI Makes America's Economy More Resilient:** After all, international companies help broaden the U.S. economy, open new markets and give other countries a stake in America's economic success.<sup>1</sup>

## Conformity Done Right Will Increase Competitiveness for International Investment

The new federal tax law drops the federal corporate income tax rate to 21 percent and adds new base broadeners. Given this seismic shift in tax policy, conformity to all Internal Revenue Code provisions could have unintended state-level policy consequences as federal base broadeners were carefully considered and implemented alongside the rate reduction to achieve policy objectives. Without a review of these state-level unintended consequences, conforming to the new tax code in its entirety could reduce a state's international competitiveness.

**Therefore, states should decouple from the new interest expense limitations imposed under IRC §163(j) to best position themselves for international investment. Decoupling from IRC §163(j) is also smart tax policy for the following reasons:**

- States would act consistently with the federal tax law's policy objective of increasing competitiveness for investment and spurring economic growth and job creation.
- States would remove threats of multiple taxation and ensure fair apportionment of income.
- States would avoid creating computational uncertainty and unnecessary administrative complexity for both taxpayers and taxing authorities.

<sup>1</sup> All data is the latest available from the U.S. Department of Commerce, released October 2017.

## States Should Decouple from the New Interest Expense Limitations Under IRC §163(j)

The new federal tax law limits interest deductibility to 30 percent of a taxpayer's adjusted taxable income. This rule applies to almost all taxpayers<sup>2</sup> and to both related party and unrelated party interest expense. It also allows for unlimited carryforwards of disallowed interest expense. States should decouple from IRC §163(j) for the following reasons:

- **Taxpayers could face higher effective state tax rates through conformity to IRC §163(j):** Congress imposed tighter interest expense limitations to pay for a lower federal tax rate, accelerated depreciation and immediate expensing. Unless states also lower rates and conform to the new federal bonus depreciation and immediate expensing rules, conforming to IRC §163(j) would misalign with congressional intent and could increase every state taxpayer's effective tax rate, as described below.<sup>3</sup>
  - First, taxpayers face tighter interest limitations to help pay for a lower federal corporate income tax rate. A corporate taxpayer's state tax liability may increase significantly if a state conforms to IRC §163(j) without a simultaneous lowering of the state's corporate income tax rate.
  - Second, as a preliminary matter, states that decouple from the new bonus depreciation and immediate expensing rules in IRC §168(k) and §179 should also decouple from the IRC §163(j) interest limitations. Congress clearly intended the interest expense limitation rule to work concurrently with new bonus depreciation and immediate expensing rules. Together, these rules encourage businesses to invest immediately in the United States, but without over-relying on debt financing. However, most states decouple from federal bonus depreciation schedules and immediate expensing rules. Therefore, conforming to §163(j) without conforming to IRC §168(k) and §179 would misalign with Congress's intent and result in corporate state tax increases.
- **Taxpayers and tax administrators would face significant federal and multistate complexity if the states conform to IRC §163(j):** The new federal tax law applies the new 30 percent interest deductibility limitation at the "taxpayer" level – a term undefined in the statute. To date, the U.S. Department of Treasury has not issued guidance regarding how the interest limitation and its carryforward will be determined.<sup>4</sup> Therefore, many taxpayers could be confused by how the interest limitation will apply because their state filing group may differ from their federal filing group.<sup>5</sup> This ambiguity would make state compliance to IRC §163(j) almost impossible for taxpayers. States that conform to IRC §163(j) could end up increasing administrative costs for both taxpayers and taxing authorities.

<sup>2</sup> It does not apply to real estate, public utilities, farmers or "floor plan financing" (essentially, automobile dealership inventory carrying costs).

<sup>3</sup> *The Impact of Federal Tax Reform on State Corporate Income Taxes*, prepared by EY for the Council on State Taxation, and its affiliate, the State Tax Research Institute. Released March 5, 2018. The report shows that state corporate income tax bases will increase by 12 percent on average over a 10-year period, with significant variations between the states. The report cites conformity to IRC §163(j) as one provision, among many cited, that will contribute to this increase in state corporate income taxes.

<sup>4</sup> While guidance has yet to be issued, federal tax policy officials have publicly announced that the U.S. Treasury Department will issue guidance confirming that the interest limitation and its carryforward will, at a minimum, be determined at the federal consolidated group level. They have also indicated that the guidance will provide clear rules for allocating the interest expense limitation, consistent with other long-standing and existing consolidated group attribute allocation rules (e.g., deferred intercompany transactions, consolidated IRC §382 loss limitation rules, separate return limitation year (SRLY) rules) intended to fairly allocate the limitation among members of the group respecting separate entity reporting. However, even with this guidance, a taxpayer's state filing group, which may be on a standalone or a group basis, may differ from its federal filing group. This would create similar complexities and uncertainties.

<sup>5</sup> A taxpayer's state reporting group often looks different than its federal filing group. For instance, over twenty states require taxpayers to file separate company returns under which group reporting is not allowed. In many cases, a taxpayer's state reporting group includes many more entities than its federal filing group. For example, depending upon a taxpayer's unitary group, members of multiple federal consolidated groups could be members of the same state reporting group, or the state could require worldwide or water's-edge reporting that includes foreign corporations that are expressly excluded from the federal consolidated group. A taxpayer's state group could also include fewer or more entities than its federal group. For instance, the federal group may consist of multiple state unitary groups or a state may only allow a group report for corporations which have nexus with the state or may exclude corporations engaged in certain kinds of business from the group because they are not subject to state income taxes (e.g., insurance companies and banks).

- **In addition to the complexity, conforming to IRC §163(j) may result in tax costs unintended by the federal provision:** If the U.S. Department of Treasury clarifies that IRC §163(j) should apply on a group basis, state application of IRC §163(j) on any other basis may result in an interest disallowance where none would occur at the federal level. Companies structure their debt financing knowing that their taxable income is computed on a consolidated basis at the federal level, which is why Treasury is expected to clarify that the new IRC §163(j) limit will apply at least at a consolidated level. If states were to apply these limits differently, taxpayers could see more significant limitations on interest expense deductibility or higher state taxes. In addition, applying limitations differently would create complex and costly administration for both taxpayers and taxing authorities.
- **Taxpayers' interest deductibility is already limited by states, making conformity to IRC §163(j) unnecessary:** Most states already limit or otherwise disallow interest deductions for their own tax policy purposes. In many cases, the states were far ahead of the federal government in this area and their rules may be even more restrictive. For example, many states limit the deductibility of interest paid to related parties through addback requirements. These are effective tools that prevent state tax base erosion. They also provide narrow exceptions, which include among others, for interest paid to related parties in countries that have a comprehensive tax treaty with the United States or that is subject to tax by another jurisdiction. It is unclear how the new interest expense limitation rules in IRC §163(j) would conflict with existing state addback rules. If states conform to IRC §163(j), a possibility exists of duplicate limitation on interest deductibility, resulting in double taxation of the affected state taxpayers. Decoupling from IRC §163(j) would minimize this uncertainty and unnecessary complexity.
- **Decoupling from IRC §163(j) would keep states competitive for international investment:** Consider how international companies grow and expand in the United States. They often borrow from a related party or bank to finance investment in the United States. Imposing tighter interest limitations at the state level, without offering a lower tax rate or providing accelerated depreciation and immediate expensing, would increase the cost of capital and impose a higher threshold to be profitable. This new hurdle could result in an investment being altered in a way that firms no longer see the return needed to justify the investment. They then could make that investment in another state.

For additional information on OFII or with questions about conformity, please contact Evan Hoffman, director of state government affairs, at [ehoffman@ofii.org](mailto:ehoffman@ofii.org).

### **About OFII**

OFII is the only organization in Washington focused exclusively on supporting the international business. OFII members are among the largest international companies with operations in the United States. While more than 60 percent of all international companies in the United States have fewer than 1,000 U.S. employees, OFII members each employ on average of more than 12,000 Americans. OFII advocates for fair, non-discriminatory treatment of foreign-based companies and promotes policies that will encourage them to establish U.S. operations, which in turn increases American employment and U.S. economic growth.

# 2018 OFII Membership List

**ABOUT OFII** The Organization for International Investment is a not-for-profit business association in Washington, D.C., representing the U.S. operations of many of the world's leading international companies. OFII advocates for fair, non-discriminatory treatment of foreign-based companies and promotes policies that will encourage them to establish U.S. operations, increase American employment and boost economic growth to ensure the United States remains the top location for global investment. For more information, please visit [www.OFII.org](http://www.OFII.org).

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Air Liquide USA  
Akzo Nobel Inc.  
Alfa Laval, Inc. (USA)  
Alibaba Group  
Allianz of North America  
Anheuser-Busch  
APG  
APL Limited  
Aptiv  
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AstraZeneca Pharmaceuticals  
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BBA Aviation  
B. Braun Medical, Inc.  
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BT  
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Continental Corporation  
Cosentino Group  
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CRH Americas, Inc.

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Direct Energy  
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Getinge Group  
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Grifols  
Grundfos

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Henkel Corporation  
Hitachi, Ltd.  
Honda North America  
HSBC Bank North America  
Holdings  
Huhtamaki  
Husqvarna AB  
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Imerys  
Infineon Technologies Americas Corp.  
InterContinental Hotels Group  
Indivior PLC  
Ipsen Biopharmaceuticals, Inc.

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Johnson Controls  
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Kerry  
Kia Motor Corporation  
Kudelski Group

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Lehigh Hanson  
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L'Oréal USA, Inc.  
Louisville Corporate Services, Inc.  
LVMH Moët Hennessy Louis Vuitton  
LyondellBasell

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Mahindra  
MAHLE Industries  
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Marubeni America Corporation  
Marvell Semiconductor  
Mazda  
McCain Foods USA  
Medtronic, Inc.  
Michael Kors  
Michelin North America, Inc.  
Mitsubishi Electric US, Inc.  
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## N

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Nestlé USA, Inc.  
The Nielsen Company  
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Nokia  
Nomura Holding America, Inc.  
Novartis Corporation  
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Ørsted North America Inc.

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Pearson Inc.  
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Philips North America LLC

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## Q

QBE the Americas

## R

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Schneider Electric USA  
Schott North America  
SCOR  
Shell Oil Company  
Shire Pharmaceuticals  
Sibelco Group  
Siemens Corporation  
Smith & Nephew, Inc.  
Smithfield  
Smiths Group  
Sodexo  
Solvay America  
Sony Corporation of America  
SSAB Americas  
Standard Chartered Bank  
Suez North America  
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Swiss Re America Holding Corp.  
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UCB  
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Volkswagen of America, Inc.  
Volvo Group North America

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White Mountains, Inc.  
Willis Towers Watson  
Wipro Inc.  
Wolters Kluwer U.S. Corporation  
WPP Group USA, Inc.

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